What Nonprofits Need to Know About the FASB Financial Reporting Standards Changes

By Fran Brown, Managing Partner

In August of 2016, the Financial Accounting Standards Board (FASB) issued the first of a few major revisions to financial reporting for not-for-profit entities. Accounting Standards Update (ASU) 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities* is the first substantive update to not-for-profit financial reporting since FAS 116 and 117 in 1993.

For many nonprofits, the impact will be substantial. Two of the more significant aspects of the changes deal with reporting on restricted net assets and "underwater" endowments. Below, we explain these and other key reporting changes nonprofits need to be aware of and begin planning for.

Restricted Net Assets

Many nonprofits have net assets that are restricted by the donor or state law. These restricted net assets are either temporarily restricted or permanently restricted. In addition, nonprofits have unrestricted net assets. Under the former reporting, financial reports had up to three columns to show the activity in each. Under the new standards, nonprofits will only report on net assets with restrictions (temporarily and permanently restricted) and net assets without restrictions (unrestricted).

The day-to-day accounting treatment for net assets is unchanged, as are the laws surrounding the use and protection of the assets. The only change is the reporting. Going forward, temporarily restricted and permanently restricted net assets will be combined for financial statement reporting purposes.

Net assets that are for the acquisition or construction of long-lived assets (i.e., property, plant, and equipment) will be *required* to be released from restrictions when the asset is placed in service. For example, if a nonprofit is conducting a capital campaign, the full amount received will be released from restriction when the building is completed and placed in service — not when the funds are used to construct the building or when the pledges are collected.

"Underwater" Endowments

"Underwater" endowments — those endowment funds that have depreciated in value — have been shown as offsets to unrestricted net assets. Under the new standards, these will stay within the "Net Assets with restrictions" category. This will affect larger nonprofits more than most.

Expense Reporting

A big change impacting all nonprofits, however, is expense reporting. Until now, nonprofits reported expenses in broad categories such as program, general and administrative, and fundraising. The new standards will require disclosure of expenses by function *and* by natural classification. In addition, the organization will need to disclose the methods used to allocate expenses among program and support functions.

Required Disclosures

One of the new disclosures will require qualitative and quantitative information on how the nonprofit will manage its liquidity risk — in other words, how the nonprofit will meet its current obligations within one year. This new disclosure should provide meaningful information on how the nonprofit will meet current obligations regardless of the appearance of health on the face of the statement of financial position.

Additional changes include disclosures around investment return and the related expenses, cash flow reporting options, and disclosures around reporting when using an operating measure. The option to use the direct method for the statement of cash flows is still optional — however, unlike previous standards, if you choose this method you no longer need to provide an indirect reconciliation.

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It's important to begin planning for these changes now.

When the Changes Take Effect

These new changes will be in effect for fiscal years beginning after December 15, 2017. If you are a calendar year-end nonprofit, your first fiscal year beginning after December 15, 2017 is January 1, 2018. If you use a fiscal year end, such as June 30, your first fiscal year-end to show the new reporting standards will be June 30, 2019. Early adoption is permitted.

When implemented, the new reporting and disclosures will apply retrospectively to all years presented for most items.

It's important to begin planning for these changes now. Please seek guidance from your engagement team as there will be additional internal costs as well as additional audit costs associated with these changes. We can help you prepare for these changes to make the process as easy and effective as possible.

Access additional FASB ASU 2016-14 resources, including articles, email alerts, and recorded webcasts, here.

About the Author

Fran Brown, Managing Partner
fbrown@capincrouse.com
o 617.535.7534

As Managing Partner, Fran leads the firm and guides the implementation of strategic plans and objectives. He is also involved in client acquisition meetings, significant board meetings, and representing the firm nationally. Fran has more than 30 years of experience providing audit and management consulting services to a variety of nonprofit entities, including colleges and universities. Fran previously led the New England Higher Education and Not-for-Profit Practice at Grant Thornton and was partner-in-charge of the not-for-profit practice at CCR LLP. His expertise includes strategic planning, budgeting, financial statement preparation, exempt-organization tax filing, real property sales and leases, board training, and enterprise risk management (ERM) training.

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